

Mongolia Strategy

Research Note
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Wave of Mongolia Resource IPOs is Heading toward Hong Kong

IPO Wave is Coming! Earlier this year, the Hong Kong Stock Exchange (HKEx) has witnessed the first full-fledged IPO of a Mongolia-focused resource company. SouthGobi Resources, a Mongolian coal miner raised over US\$460mn on the HKEx in January 2010. Last week Reuters reported that Energy Resources, another Mongolian coal miner plans to launch its IPO in Hong Kong later this year. We expect that at least a dozen of Mongolian resource companies and conglomerates to raise capital in Hong Kong in the next three years.

Hong Kong is “a natural choice” for Mongolian IPOs. “Hong Kong is a natural choice in terms of funding and expertise for Mongolia”, Sukhbaatar Batbold, Prime Minister of Mongolia stated in April this year in Hong Kong. In our view, a number of positive factors such as Mongolia’s strategic proximity to China, strong interest from HK and Asia-based investors, Mongolia and Hong Kong being in the same time zone and growing Mongolia-focused peer group at the HKEx provides Hong Kong with a competitive advantage over its global rivals like London and Toronto to lure Mongolian resource companies to Asia’s largest stock exchange, ex-Japan.

Mongolian Companies to Raise US\$3bn in Hong Kong. We estimate that Mongolian resource companies from the private sector alone will raise at least US\$3bn in Hong Kong through IPOs and equity placements within three years. Some of forthcoming IPOs include:

- **Energy Resources**, a coal company with the largest mining license area in Mongolia, is seeking to raise **US\$800mn to US\$1bn** in a HKEx IPO by the end of this year
- **Winsway Coking Coal**, the largest offtaker of Mongolian coal, backed by a consortium of Hopu Investment Management, Itochi Corp and China Minmetals, announced its plan to go public with estimated **US\$800mn** IPO in Hong Kong in Q4 2010
- **Iron Mining International**, which owns and operates a Mongolian iron ore mine and backed by China Investment Corp, Temasek and Hopu, intends to undertake about **US\$1bn** IPO in Hong Kong in Q4 2010 or earlier 2011

“National Champions” are set to launch the biggest Mongolian IPOs. Mongolia, seeking to privatize more than 50 state owned enterprises, is planning to establish National Holding Companies in mining, energy and infrastructure and list them on international stock exchanges with Hong Kong being a top contender.

Mongolia is largest IPO market in frontier Asia. We expect Mongolia resource companies to generate largest IPOs among frontier and emerging markets in Asia triggering frenzy among competing stock exchanges and global investment banks alike (and investors too!)

Who will make most from these IPOs? We estimate that HK IPOs of Mongolian companies will create **US\$25bn in shareholder value** by the end of 2013. However, company founders, original backers and early investors will capture the most of this staggering value.

Most important takeaway: Invest Locally! We strongly advise investors to gain exposure to the Mongolia story by investing across local asset classes in Mongolia. Only early investors willing to invest locally in Mongolia will most likely to make outsized returns.

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Mongolian Companies to Raise US\$3bn in Hong Kong

Earlier this year, the Hong Kong Stock Exchange (HKEx) has witnessed the first full-fledged IPO of a Mongolia-focused resource company. SouthGobi Resources, a Mongolian coal miner raised over US\$460mn on the HKEx in January 2010. Last week Reuters reported that Energy Resources, another Mongolian coal miner plans to launch its IPO in Hong Kong later this year. We expect that at least a dozen of Mongolian resource companies and conglomerates to raise capital in Hong Kong in the next three years.

We estimate that Mongolian resource companies from the private sector alone will raise at least US\$3bn in Hong Kong through IPOs and equity placements within three years. Some of forthcoming IPOs include:

- **Energy Resources (ER)**, a coal company with the largest mining license area in Mongolia, is seeking to raise **US\$800mn to US\$1bn** in a HKEx IPO by the end of this year. ER owns a mining license for Ukhaa Khudag's coking coal deposit. The Company produced about 1.8 million tonnes of coking coal last year, and intends to increase the output to as much as 4 million tonnes this year. MCS Group, the largest private business conglomerate in Mongolia, owns more than half of ER. Other shareholders include Petrovis LLC, Shunkhlai Group as well as the EBRD. Citigroup and JP Morgan are reportedly acting as the sponsors of the offering.
- **Winsway Coking Coal**, the largest offtaker of Mongolian coal, backed by a consortium of Hopu Investment Management, Itochi Corp and China Minmetals announced its plan to go public with estimated **US\$800mn** IPO in Hong Kong in Q4 2010. Winsway acquired a 50% stake in Peabody-Polo Resources B.V for US\$35mn in May this year. The company reportedly appointed Goldman Sachs and Deutsche Bank for the IPO. Peabody-Polo joint venture operates the Erds Coal Project, which contains a JORC compliant resource of 807 million tonnes of thermal coal in Mongolia.
- **Iron Mining International (IMI)**, which owns and operates a Mongolian iron ore mine, intends to undertake about **US\$1bn** IPO on the HKEx by the end of 2010 or earlier 2011. The Company has a high profile of investors such as China Investment Corp (invested US\$700mn), private equity firm Hopu Investment Management jointly with Temasek (jointly US\$300mn) and Credit Suisse (US\$120mn). IMI has also secured a US\$250mn investment from China Life ahead of its planned IPO.

We estimate that Mongolian resources companies from the private sector alone will raise US\$3bn in Hong Kong within three years

- **Gobi Coal and Energy**, a coal company, backed by a group of private equity and hedge funds. The company is planning to launch a HKEx IPO in 2011. Origo Partners, a private equity firm is the largest outside investor with a 25% stake in GCE while the management owns 35%.

“National Champions” to Launch the Biggest Mongolian IPOs

We expect the Mongolian resource companies from private sector to take the lead in launching their IPOs in Hong Kong, ahead of the Mongolian state-owned enterprises (SOEs). However, the initial US\$3bn worth of expected IPOs from the private sector companies will be just the beginning of a stream of substantial capital raising by the Mongolian SOEs. Seeking to privatize over 50 enterprises, the Mongolian government is planning to establish major National Holding Companies in mining, energy and infrastructure and list them on international stock exchanges with Hong Kong being a top contender.

The Mongolian government estimates that the monetary value of the country’s ten largest strategic deposits (copper, coal, gold, uranium and other metals) is over US\$1.3trln. Resources of Tavan Tolgoi, the world’s largest undeveloped coking coal mine alone are worth US\$370bn in monetary value today. 30% stake in new Erdenes Tavan Tolgoi that will own the mining license for Tavan Tolgoi is expected to be floated domestically and internationally.

The Mongolian government plans to build a multi-billion dollar extensive railway network connecting its key mines to export routes in China and Russia. The government is also intends to launch \$10 billion industrial complex at Sainshand in Gobi desert to house copper smelter, oil refinery, power plants and coal washing and coking facilities.

In order to fund these ambitious infrastructure and industrial projects would require the Mongolian SOEs need to raise billions of dollars from international capital markets in coming years.

Hong Kong is a Natural Choice for Mongolian IPOs

“Hong Kong is a natural choice in terms of funding and expertise for Mongolia”, Sukhbaatar Batbold, Prime Minister of Mongolia, stated in April this year in Hong Kong. In our view, a number of positive factors such as Mongolia’s strategic proximity to China, strong interest from HK and Asia-based investors, Mongolia and Hong Kong being in the same time zone and growing Mongolia-focused peer group at the HKEx provides Hong Kong with a competitive advantage over its global rivals like London and Toronto to lure Mongolian resource companies to Asia’s largest stock exchange, ex-Japan.

In 2009 Hong Kong has surpassed both New York and London in terms of the total amount of capital raised through IPOs. The HKEx has also become an

“Hong Kong is a natural choice for us in terms of funding and expertise,” Sukhbaatar Batbold, Prime Minister of Mongolia

important source of capital for resource companies as ten mining and metal companies launched IPOs on the HKEx in the last 18 months.

In 2009, it was number one among the world stock exchanges in IPO capital raising, derivative warrant turnover and stock options market. Current high valuation of the mining sector on the HKEx (P/E 24) indicates growing investor confidence about the industry. Since 2007, international metals and mining companies raised over US\$9bn in IPOs in Hong Kong, representing 23% of total. Over the last 18 months ten metals and mining companies completed their IPOs on the HKEx. UC Rusal, the world's largest aluminum producer raised US\$2.2bn in Hong Kong in January 2010, one of the largest IPOs this year.

Conclusion

We expect Mongolia companies to generate largest IPOs among frontier and emerging markets in Asia triggering frenzy among competing stock exchanges. In our view, among major stock exchanges, HKEx will host the majority of IPOs by Mongolia-related resources companies in coming years. As a result, Mongolia companies will likely be responsible for the largest amount of equity capital raised and total market capitalization on the HKEx among foreign issuers.

By the end of 2013, we estimates that the total market capitalization of Mongolia-focused companies listed on HKEx to exceed **US\$30bn** (the current level is US\$5bn). This would represent the creation of **additional US\$25 billion in shareholder value**, related to diverse assets in Mongolia. However, **the most of these billions of dollars in value will go to company founders, original backers and early investors.**

We anticipate that the Hong Kong IPOs of Mongolia resource companies would not be priced too generously by investment banks so these shares would not come cheap for investors. However, many investors would be willing to bet on Mongolia, which, we expect, to become the fastest growing economy in Asia throughout next decade with its GDP growing on average 15% per annum during that period.

We reckon that long term investors will do well with many of forthcoming HK and international IPOs from Mongolia. Yet, **we strongly advise investors to gain exposure to the Mongolia story by investing locally. Only early investors willing to invest in the local equities market, property and other asset classes in Mongolia are most likely to generate truly outsized returns.**

By the end of 2013, the total market value of Mongolia-focused companies listed in Hong Kong will go up by six times to \$30bn

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